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Deloitte global IFRS leadership team

IFRS global office

Global IFRS leader
Ken Wild
kwild@deloitte.co.uk

IFRS centres of excellence

Americas

New York
Robert Uhl
iasplusamericas@deloitte.com

Montreal
Robert Lefrancois
iasplus@deloitte.ca

Asia-Pacific

Hong Kong
Stephen Taylor
iasplus@deloitte.com.hk

Melbourne
Bruce Porter
iasplus@deloitte.com.au

Europe-Africa

Johannesburg
Graeme Berry
iasplus@deloitte.co.za

Copenhagen
Jan Peter Larsen
dk_iasplus@deloitte.dk

London
Veronica Poole
iasplus@deloitte.co.uk

Paris
Laurence Rivat
iasplus@deloitte.fr

New Interpretation on non-cash distributions

On 27 November 2008, the International Financial Reporting Interpretations Committee (IFRIC) issued IFRIC 17 **Distributions of Non-cash Assets to Owners.** The Interpretation provides guidance on the appropriate accounting treatment when an entity distributes assets other than cash as dividends to its shareholders. The specific questions addressed in the Interpretation are:

- when should the entity recognise the dividend payable?
- how should the entity measure the dividend payable?
- when the entity settles the dividend payable, how should it account for any difference between the carrying amount of the assets distributed and the carrying amount of the dividend payable?

The most significant conclusion reached by the IFRIC is that the dividend should be measured at the fair value of the assets distributed, and that any difference between this amount and the previous carrying amount of the assets distributed should be recognised in profit or loss when the entity settles the dividend payable. This accounting treatment will result in a change in practice in many jurisdictions.

Importantly, the Interpretation does not apply to distributions of non-cash assets where the asset is ultimately controlled by the same party or parties before and after the distribution (e.g. distributions of non-cash assets between entities under common control) which is the most common circumstance in which such distributions occur.

The Interpretation has resulted in consequential amendments to IFRS 5 **Non-current Assets Held for Sale and Discontinued Operations** regarding the appropriate treatment of the non-cash assets held for distribution.

The scope of the Interpretation, the consensus reached by the IFRIC on each of the issues addressed, and the consequential amendments to IFRS 5 are discussed in the remainder of this newsletter.

IFRIC 17 is to be applied prospectively for annual periods beginning on or after 1 July 2009.

Scope

In general terms, the Interpretation applies to non-reciprocal distributions of non-cash assets made by an entity to its shareholders acting in their capacity as owners. This incorporates:

- distributions of non-cash assets (e.g. items of property, plant and equipment, businesses as defined in IFRS 3 **Business Combinations,** ownership interests in another entity and disposal groups as defined in IFRS 5); and
- distributions that give owners a choice of receiving either non-cash assets or a cash alternative.

Specifically excluded from the scope of the Interpretation are:

- distributions in which all owners of the same class of equity instruments are not treated equally. For example, the Interpretation will not apply if the distribution is made to a specific shareholder and is not offered to other shareholders of the same class of shares;
- distributions of non-cash assets that are ultimately controlled by the same party or parties before and after the distribution; and
- distributions by an entity of some of its ownership interest in a subsidiary where the entity retains control of that subsidiary. In such circumstances, IAS 27 **Consolidated and Separate Financial Statements** sets out the appropriate accounting treatment.

Consensus

Recognition of the dividend payable

The Interpretation follows the general principle that an entity should recognise a liability when it has incurred an obligation to pay that liability. In the context of non-cash distributions, the point at which an obligation arises is the point at which the dividend is appropriately authorised (and is no longer at the discretion of the entity), which will vary according to the legal requirements in particular jurisdictions. IFRIC 17 concludes that the entity should recognise a liability for a non-cash distribution:

- in jurisdictions where the approval of shareholders (or an equivalent authority) is required, when that approval is obtained; and
- in jurisdictions where further approval of dividends is not required, when the dividend is declared (e.g. by management or the board of directors).

Measurement of the dividend payable

The liability should be measured at the fair value of the non-cash assets to be distributed.

If shareholders have a choice of receiving either a non-cash asset or a cash alternative, the liability should be measured considering both the fair value of each alternative and management's assessment of the probabilities for each outcome.

Accounting for any difference

When an entity settles the dividend payable, IFRIC 17 requires that it should recognise the difference, if any, between the carrying amount of the assets distributed and the carrying amount of the dividend payable in profit or loss.

The impact of these requirements is illustrated in the following example.

Entity A wishes to distribute to its owners land with a carrying amount of CU20 million (determined under IAS 16's cost model). The fair value of the land is CU30 million. At the date the shareholders approve the dividend (such approval being required in the jurisdiction in which Entity A operates), the entity recognises a liability for CU30 million and debits equity with the same amount, as follows:

		CUm	CUm
DR	Equity (retained earnings)	30	
CR	Liabilities (dividend payable)		30

If the liability remains outstanding at the end of a reporting period and the fair value of the non-cash asset has changed, the liability is remeasured through equity as an adjustment to the amount of the distribution.

Continuing the previous example, if the liability has not been settled at the end of the reporting period and the fair value of the land has increased to CU32m, Entity A debits to retained earnings an additional CU2m and increases the liability to CU32 million.

If the fair value of the non-cash asset changes between the date on which the liability is recognised and the date of settlement, the liability is remeasured through equity (retained earnings) and, on settlement, profit or loss is affected.

Continuing the previous example, if the fair value of the land has increased to CU34m on the date of settlement, the net effect is to debit to retained earnings an additional CU2m and to increase the gain on distribution of the asset to CU14m.

On settlement of the liability, the following entries would be required:

		CUm	CUm
DR	Liabilities (dividend payable)	32	
DR	Equity (retained earnings)	2	
CR	Land		20
CR	Profit or loss (gain on distribution of asset)		14

Presentation and disclosure

Amounts recognised in profit or loss as a result of a non-cash distribution (as described in the example above) are required to be presented as a separate line item in profit or loss.

For liabilities recognised in the statement of financial position at the end of the reporting period, the entity is required to disclose:

- the carrying amount of the dividend payable at the beginning and end of the period; and
- any change in the liability recognised during the period as a result of a change in the fair value of the non-cash asset to be distributed.

If, after the end of the reporting period but before the financial statements are authorised for issue, the entity declares a non-cash dividend, this is a non-adjusting event after the reporting period. In such circumstances, the entity is required to disclose:

- the nature of the asset to be distributed;
- the carrying amount of the asset at the end of the reporting period; and
- the estimated fair value of the asset as of the end of the reporting period, if different from the carrying amount, and information about the method used to determine that fair value as required by IFRS 7 paragraphs 27(a) and (b).

Non-cash assets held for distribution (amendments to IFRS 5)

Non-cash assets held for distribution to owners are now specifically scoped in to IFRS 5 and should be treated in accordance with IFRS 5's classification, presentation and measurement requirements.

Whether or not a non-cash asset is classified as 'held for distribution to owners' is determined using IFRS 5's general principles regarding whether the transaction is highly probable. Reclassification under IFRS 5 can be triggered in advance of approval by shareholders, but it will be necessary to consider the probability of that approval being obtained (if required in the jurisdiction) as part of the assessment as to whether the transaction is highly probable.

When the non-cash asset is classified as held for distribution to owners, it is remeasured at the lower of its carrying amount and fair value less costs to distribute, with any adjustment to carrying amount recognised in accordance with the general principles of IFRS 5. Therefore, where the fair value less costs to distribute of an asset accounted for using the cost model is less than its carrying amount, an impairment loss should be recognised in profit or loss. Where the fair value less costs to distribute is higher than the carrying amount, no adjustment is made until the distribution is made.

Effective date and transition

IFRIC 17, and the consequential amendments to IFRS 5, are effective for annual periods beginning on or after 1 July 2009. Earlier application is permitted, provided that fact is disclosed and that IFRS 3(2008) and IAS 27(2008) are applied from the same date.

The Interpretation, and the consequential amendments to IFRS 5, are to be applied prospectively – retrospective application is not permitted.

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